Market Review and Outlook

Q1 2017

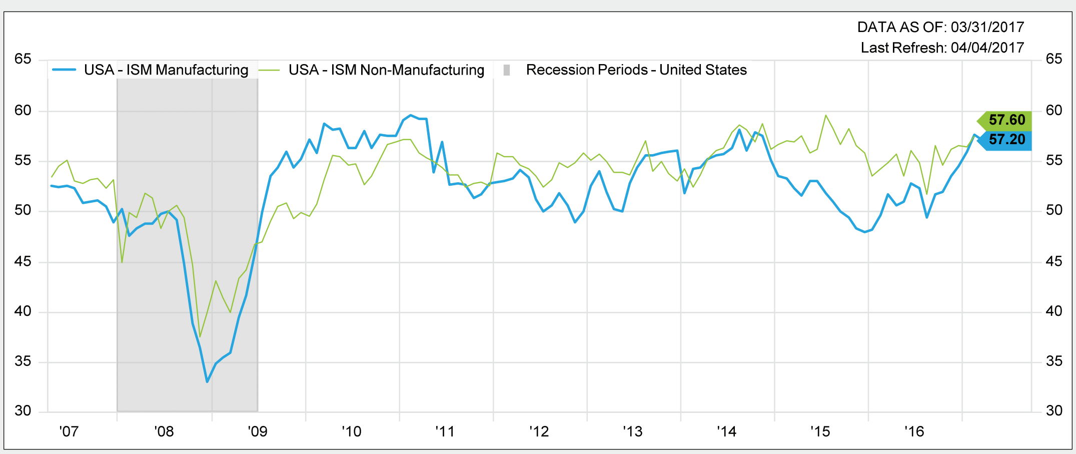
EGA U.S. Equity

From the EGA Portfolio Management Team

A rally in Information Technology, Health Care and Consumer Discretionary stocks drove the U.S. indices to new records despite increased doubts about the Trump administration's ability to pass its business friendly agenda. Nevertheless, the S&P 500 Index returned +6.1% for the quarter while international equity markets, represented by the MSCI EAFE Index, returned +7.3%. Interest rates were mixed during the quarter, leading to generally positive returns in fixed income. On balance we think the positive economic momentum, not just in the U.S. but globally, creates a good near-term environment for global equities. We do remain concerned about a pick up in inflation and an upturn in interest rate policy by the Federal Reserve which could present problems down the road.

Economy: *Soft vs. hard data*

Q4 real GDP was revised up to a 2.1% annual rate from 1.9%, the fastest pace in two years, and above consensus estimate of 2.0%. There is an expectation of faster growth in 2017, as the post-election surge in consumer and business confidence (soft data) translates into somewhat stronger spending and investment growth (hard data). However, so far the soft data has outperformed expectations while the hard data has been largely in line with expectations. This dichotomy in soft and hard data has received some scrutiny over the last few weeks leading to widely diverse outlooks for near-term growth. Federal Reserve Bank of Atlanta's GDPNow model, which primarily uses hard data to calculate tracking figures, forecasts 1.2% growth for the first quarter of 2017. The Federal Reserve Bank of New York, which incorporates soft data into its tracking, projects 2.9% growth for the same period.

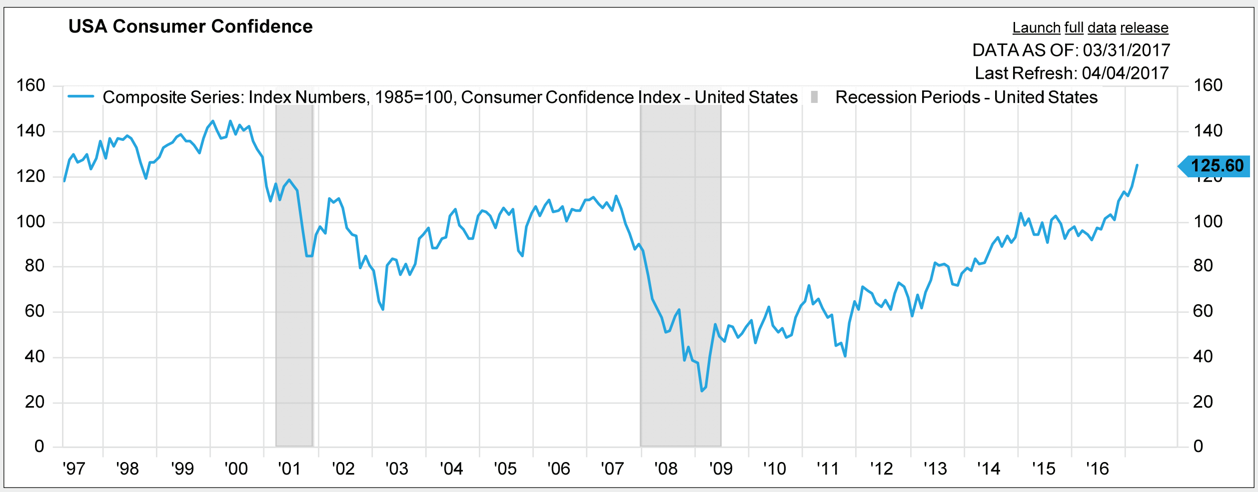


Source: ISM Report, Factset

The ISM Manufacturing Index slipped 0.5 points in March to 57.2, below the consensus of 57.5, indicating a slight moderation in factory activity. But the latest index reading remains historically consistent with above-trend growth in manufacturing output. The ISM estimates that the index readings so far suggest a 4.3% real GDP growth on an annualized basis.

The NFIB Small Business Optimism Index edged down 0.6 points in February to 105.3, following a record surge in the aftermath of the presidential election. The modest pullback in confidence was driven by easing of compensation and price forecasts. The Duke University/CFO Magazine Business Outlook Survey rose 2.0 points to 68.5 in Q1, its highest level since Q2 2004, extending its post-election gains. CFOs expect 8.6% earnings growth over the next 12 months, the best since Q4 2015. Their capital spending plans, as well as spending on technology and R&D, picked up notably. Full-time hiring plans were the highest in 13 years. The NAHB/Wells Fargo Housing Market Index (HMI) rebounded six points in March to 71, its highest level since June 2005, and above the consensus of 65. Builder optimism surged in response to President Trump's executive actions on deregulation.

The Conference Board's Consumer Confidence Index jumped 9.5 points in March, the most since August 2015, to 125.6, its highest level since December 2000. Such a high level of confidence has historically been associated with above-trend economic growth. We have yet to see this level of consumer exuberance translate into notably faster spending growth. Confidence was mixed by income level, but very strong among high-income earners. Confidence increased among all age groups, but increased sharply among 55+ year olds. Purchase plans were mixed. Plans to buy an automobile advanced, contrary to a negative seasonal tendency in March. Plans to buy a home edged down slightly. Plans to buy major appliances exceeded their seasonal tendency.



Source: The Conference Board, Factset

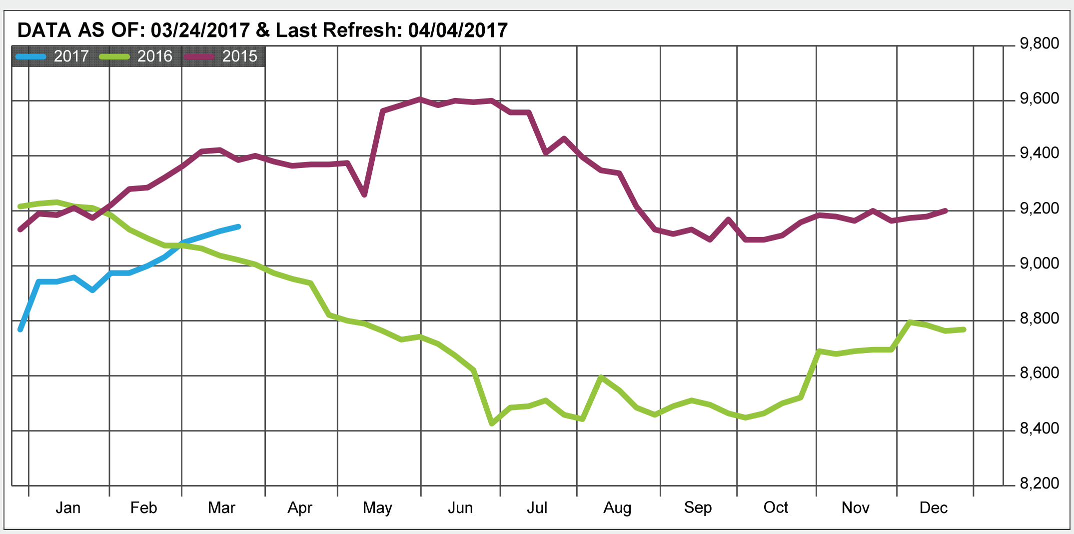
The housing market had another mixed quarter. Existing home sales fell 3.7% in February, falling in two of the prior three months and by the most in a year. The consensus was for a smaller 2.5% pullback. However, the pending home sales index rebounded 5.5% in February, more than double the consensus of 2.1%. It was the biggest increase since April 2010, and brought the index to its second highest level since May 2006. The jump in pending sales suggests existing home sales would also pick up over the next few months. Housing starts rebounded 3.0% in February to a 1.288 million unit annual rate, above the consensus for a 0.8% gain. The increase, partly due to warmer-than-normal weather, was led by single-family starts, which picked up 6.5% to 872,000 annual units, the highest level since October 2007. But, building permits fell 6.2%, the most in nearly a year to a 1.213 million unit annual rate, and below the consensus of a 1.250 million unit rate. The S&P/Case-Shiller U.S. National Home Price Index for January rose 5.8% from a year ago.

The unemployment rate dropped from 4.8% in January to 4.7% in February as warmer than normal weather helped hiring. Private nonfarm payrolls increased 227,000, above the 12-month average of 180,000, driven by 58,000 net new jobs in construction and 28,000 in manufacturing. The labor force participation rate increased to 63% from 62.9% in January, materially above the cycle low of 62.4%. The number of people working part-time for economic reasons fell by 136,000 to 5.704 million, close to its lowest level since June 2008. As a result, the broadest measure of the unemployment rate, U6, fell back to 9.2% from 9.4%, matching its lowest level since April 2008.

Oil: *Recovering, but concerns remain*

WTI crude oil prices declined -5.8% during the quarter amid concerns about rising U.S. inventory and extension of the OPEC and non-OPEC production cuts (when they come up for renewal in May) while U.S. shale activity continues to rebound. The sell-off was exacerbated by the overly bullish investor positioning in the crude oil futures and options market. Oil demand is expected to rise by about 1 million barrels per day quarter-on-quarter in Q2, with refinery maintenance peaking soon. Meanwhile, non-OPEC oil supply is expected to fall even factoring in U.S. oil production growth. While U.S. shale production should continue to rebound, we think the dramatic curtailment in capital expenditure by oil companies worldwide since 2014 should start to materially curtail global oil supply growth going forward. Over time, the crude oil supply demand gap should narrow.

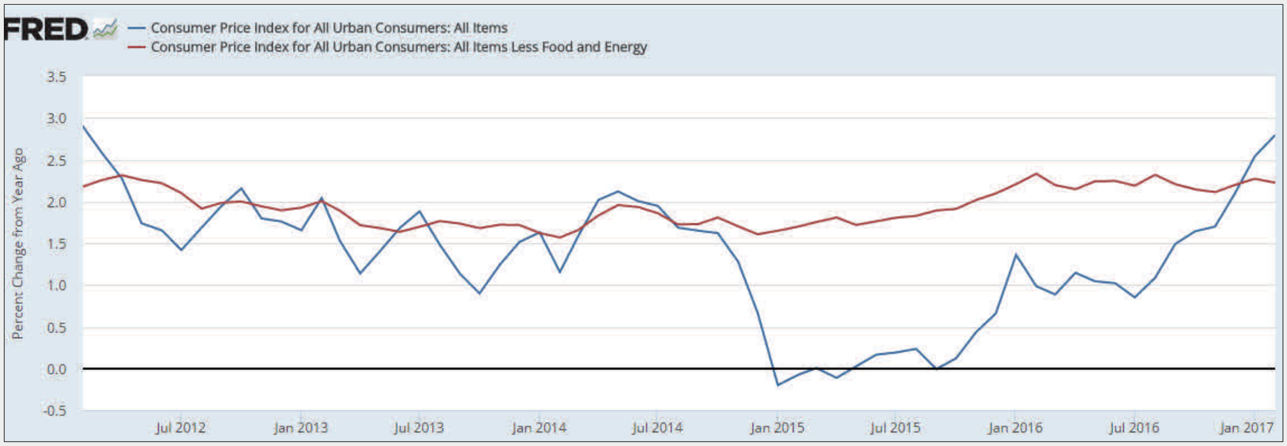
U.S. Crude Oil Field Production (000 bbls/day)



Source: EIA, Factset

Inflation: *Ticking up*

The Consumer Price Index (CPI) rose 2.7% (over prior year) in February, the most since 2012 and led by energy. Excluding food and energy, prices were up 2.2%. Average hourly earnings grew at the highest rate since the financial crisis at 2.8% in February, above the consensus of 2.7%. We expect the rate of inflation to continue to rise in 2017 as the labor market tightens and wage growth accelerates.



Source: Bureau of Labor Statistics

Corporate Profits: *Profits expected to rise sharply*

According to Starmine "Smart Estimates", earnings for the S&P 500 Index will grow (versus a year ago) by 9.7% in the first quarter of 2017, driven by a projected increase of 16% in Financials and 13% each in Information Technology and Materials. Industrials, Telecom Services and Consumer Discretionary sectors are projected to post negative growth rates. With the S&P 500 Index currently near 2357, the Price-to-Earnings Ratio of the market is around 18 times the 2017 mean earnings estimate (compiled by Factset), above its long-term average. While valuations are a bit above average levels, stocks do not appear expensive relative to bonds and inflation, which are still historically low. Also supporting valuations is robust expected earnings growth. According to Factset, S&P 500 earnings are expected to grow a solid 10% in 2017.

Interest Rates: *Federal Reserve indicates three rate hikes in 2017*

After raising the federal funds rate in December, the Federal Reserve had given no indication that they were in a hurry to raise rates any time soon but still maintained their projections for a total of three rate hikes this year. However, a drumbeat of commentary from Fed officials in early March signaled that they were seriously considering an increase at their March 23, 2017 meeting. When the Fed did raise the federal funds rate by one quarter point to 0.75% to 1.0% at their March meeting, both the stock market and bond market rallied. The upbeat backdrop of rising asset prices, low interest rates and a strong dollar gave the Fed room to raise rates without rattling markets and hurting the economy. The reason that the bond market rallied is that many market participants were starting to bake in four rate hikes this year instead of three. When policymakers stuck with median projections that there will be a total of three increases this year, the bond market was relieved and rallied. Until the modest post-meeting bond market rally, the 10-year Treasury yield had continued to climb since the Trump victory in November to a peak of 2.6% the week before their March meeting in expectation of stronger growth and higher inflation under the new administration.

International

The latest global leading indicators point to above-trend growth. Additionally, inflation is firming in nearly all developed markets. Developed Europe topped the list with the highest Purchasing Manager Indices (PMIs) in the world, led by Sweden, Switzerland, Germany, and the Netherlands, which reported PMIs at or near their best levels in roughly six years. Notably, the Eurozone reported its best PMI since April 2011. An improving labor market, high confidence levels and ultra-loose monetary policy are acting as tailwinds for the Eurozone.

There is some concern that firmer economic momentum and rising inflation will cause the ECB to announce a tapering of its bond buying program later this year. U.K.'s PMI slipped for a third straight month to 54.2, but remains astoundingly resilient considering the uncertainty surrounding Brexit. U.K. Prime Minister Theresa May invoked Article 50, triggering the long-awaited Brexit process and sending the European Union and the United Kingdom into unchartered waters. Japan's PMI was down for the first time in four months and by the most in a year, but also held firmly in growth territory. Emerging markets have not fared as well as the developed world, but are continuing to gain solid footing. China's Markit PMI edged down modestly, but held in expansion territory for the seventh straight month. The government's index, which includes a more diverse survey than Markit, saw its PMI climb to its best level since April 2012.

Elections continue to dominate the news flow in the Eurozone. Results of the first vote in the Netherlands saw the country shrug off earlier worries that the far-right could make significant inroads. Next up is France, which will hold the first round on April 23 of the most uncertain presidential vote in its recent history. While right-wing Eurosceptic Marine Le Pen is widely expected to advance through the first stage of the French presidential election, polls indicate strongly she is expected to lose the final round to either the center-right or center-left candidate. Germany will also hold a general election later this year, which has the potential to facilitate a change in key Eurozone leadership. However, Chancellor Angela Merkel's Christian Democratic Union Party firmly won a regional election on March 26th, in an important test of mood among voters. At this stage domestic political risks in the region seem contained.

Investment Strategy

Domestic Equity: *U.S. equities outperform*

Eagle domestic equity portfolios performed in line with the S&P 500 Index during the first quarter. Individual portfolio returns may differ due to cash flows, tax management, and other factors. Stock selection was positive in the Consumer Discretionary, Materials and Information Technology sectors. Sector allocation was also positive, driven by our strategy of being underweight in Telecommunication Services and overweight in Information Technology. Our largest overweight allocations are in Financials and Information Technology. Consumer Staples, Utilities and Real Estate are the largest underweights. During the quarter we increased our exposure to Information Technology, Real Estate and Energy while reducing our exposure to Industrials and Materials. Top performers for the quarter: Micron, Apple and CF Industries. Disappointments for the quarter: AIG, Qualcomm and Hess. New buys/additions during the quarter: Arch Coal, Dr. Pepper, Gilead, Goldman Sachs, Morgan Stanley, Real Estate SPDR and Paypal. New sells/trims: AIG, CF Industries, Coca Cola, Hartford Financial, McKesson and Transdigm.

International Equity: *International equities rise*

Eagle international equity portfolios lagged the MSCI EAFE Index. Stock selection hurt relative performance in Financials, Telecommunication Services and Health Care. Country allocation was slightly negative due to underweights in Canada and Australia. We increased the portfolio's exposure to Industrials, Energy and Materials while decreasing exposure to the Health Care and Consumer Discretionary sectors. Top performers: Valeo, BOC Hong Kong and DBS Group Holdings. Disappointments: BT Group, Orix and Fuji Heavy Industries. New buys/additions during the quarter: Aegon and East Japan Railway. New sells/ trims: BT Group.

Fixed Income: *Higher rates expected*

The Federal Reserve has clearly become more positive on the outlook for the economy. In her press conference, Chairperson Yellen said "We have confidence in the robustness of the economy and its resilience to shocks" and "The simple message is the economy's doing well." Additionally, the Fed has raised their inflationary expectations. For the first time in years, the Committee stated that "Inflation has increased in recent quarters, moving closer to the Committee's 2% longer-run objective". Previously, they had stated repeatedly that "inflation remains below their 2% longer-run objective." Greater confidence in inflation was clearly an important consideration in deciding to raise rates earlier than was previously expected.

Given the Fed's positive outlook for the economy and expectations for higher inflation, we expect them to continue raising rates over the next few years unless the economy stumbles. Projections provided following their March meeting showed that the Fed maintained their future projections for three rate hikes this year, another three rate hikes in 2018 and another three in 2019 with the Fed funds rate projected to reach 3% by the end of 2019.

With the outlook for higher rates over the next few years, we are maintaining a duration that is shorter than the index to help protect the value of your fixed income portfolios and provide the opportunity to reinvest the proceeds from maturing bonds at higher rates over time. Our shorter duration has helped us to outperform the benchmark. As attractive opportunities present themselves we will be taking advantage of bumps in interest rates but will maintain our cautious stance in the meantime. In taxable accounts we continue to favor corporate bonds over lower yielding government bonds.